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No. 88-1250

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

The petition showed that the FCC's rate-of-return prescription/refund scheme violates the "rule against retroactive ratemaking" that preserves the balance between utility and customer interests established in the Communications Act and similar federal regulatory statutes. Review should be granted because the decision below, upholding the concededly "asymmetric" FCC scheme that imposes upon carriers all of the risks inherent in designing rates to achieve a specified rate of return, conflicts with numerous decisions of this Court and the courts of appeals.

Respondents do not directly challenge this central argument of the petition. Instead, they attempt to avoid the issue by making three unfounded contentions.

1. Respondents describe Section 4(i) of the Communications Act as a " 'necessary and proper' " clause (Opp. 17, *quoting North American Telecommunications Ass'n* v. *FCC*, 772 F.2d 1282 (7th Cir. 1985)), that enables the FCC to select any remedy that it wishes to enforce a prescription order. But, as we showed in the petition (pp. 18-19) and as the Seventh Circuit observed in that case, 772 F.2d at 1292, "Section 4(i) is not infinitely elastic;" "as its language makes clear," it cannot be used "to contravene another provision of the Act." Thus, as demonstrated in the petition, the FCC cannot rely upon the general authority granted by Section 4(i) to contravene Section 205(a) and the other provisions of the Communications Act which codify the rule against retroactive ratemaking.[1]

Respondents next suggest (Opp. 17-18) that resort to Section 4(i) to sustain a refund order is "necessary" to enforce a rate-of-return prescription. But, as Judge Starr observed in his separate opinion in the *Rulemaking Case*, the FCC can enforce such a prescription order by "summarily . . . reject[ing] any tariff revision designed to achieve more than the prescribed rate of return." Pet.

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[1] The D.C. Circuit recently rejected the contention that Section 16 of the Natural Gas Act ("NGA"), which corresponds to Section 4(i), "functioned as a sort of statutory equivalent of the Constitution's 'necessary and proper' clause." *Public Service Comm'n of New York* v. *FERC*, 866 F.2d 487, 491 (D.C. Cir. 1989). Noting that the NGA "sets up a carefully balanced mechanism for the [FERC's] supervision of natural gas company rates," *id.* at 488, the court concluded that there was "no basis for reading § 16 as overriding the balance achieved by §§ 4 and 5, and [found] FERC's expansive view of its § 16 powers to be contrary to the purposes of the Act." *Id.* at 492.

See also, Louisiana Public Service Comm'n v. *FCC*, 476 U.S. 355, 370 (1986) ("we would be disinclined to favor the provision declaring a general statutory purpose, as opposed to the provision which defines the jurisdictional reach of the agency formed to implement that purpose").

App. 159a. In addition, as Judge Starr also noted, the Commission has the power under Section 205 "to prescribe just and reasonable charges *for the future*" if, contrary to its and the carrier's original expectations, events subsequent to the filing of the rates lead to higher earnings. *Id.* at 157a (emphasis in original). Thus, it is not necessary to enforce a rate-of-return prescription by refunds that violate the rule against retroactive ratemaking and distort the balance established in the Communications Act.

Respondents argue (Opp. 18) that refunds are accepted regulatory techniques and that the courts should not restrict agency discretion to order them. However, Section 204(a) specifically limits refunds only to carefully defined circumstances, which as shown below, pp. 5-6, are not present here. Indeed, as noted in the petition (p. 16), the fact that Congress authorized refunds only under Section 204(a) and specifically failed to authorize them to enforce prescription orders under Section 205, in and of itself exposes the FCC's error in ordering a refund in this case.

Respondents seek to obscure the "asymmetry" inherent in a scheme that forces carriers to suffer inadequate earnings, while allowing customer refunds for excess earnings, by contending that a carrier can file rate increases to protect itself from "anticipated shortfalls" in earnings. (Opp. 20; *see also*, *id.* at 12, 22). But this argument simply ignores the uncertainties inherent in rate design. As shown in the petition (p. 11), it is not always possible for carriers to anticipate shortfalls because they cannot predict with precision the actual return that will be earned.[2] This point is vividly illustrated by

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[2] Respondents unwittingly concede this point when they state (Opp. 17) that "not until revenues are actually collected can it be determined whether the carrier actually exceeded the prescribed rate of return."

Bell's 1976 results, when its newly-filed rates produced earnings below the prescribed rate of return.[3] Because carriers cannot accurately forecast all of the myriad factors that will affect their return, the practical effect of the Commission's refund scheme is to impose all of the risks of shortfall on the carriers, upsetting the balance of customer and carrier interests established by the rule against retroactive rate-making.

Respondents have never disputed that Bell's rates were set in a good faith effort to achieve the prescribed rate of return. Rather, they suggest that the carrier's state of mind is irrelevant (Opp. 10, *quoting* Pet. App. 9a). But, as noted in the petition (p. 17), the sole provision in the Act that expressly provides a remedy for violations of prescription orders is Section 205(b), which requires a showing of "willful" violation of such orders. Thus, under Section 205(b), if the FCC had determined that Bell knew its rates would generate returns above the prescribed level, it could have imposed substantial fines to enforce that prescription. However, the FCC has never found nor suggested that Bell knew or should have known, on January 1, 1978, that its then two-year-old rates would produce a return above 10% for the coming year.

2. The Solicitor General all but concedes that the stated grounds for the Commission's action and the court of appeals' decision are suspect. Thus, in addition to pressing the Section 4(i) argument, he contends (Opp. 23-28) that the FCC and the court below could have

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[3] Respondents seek to explain Bell's inadequate earnings in 1976 on the ground that its new higher rates premised upon the 9.5% return prescription were effective for only the last 10 months of that year. (Opp. 21 n.17). However, as shown in the petition (p. 6, n.9), Bell earned significantly less than 9.5% during the last 10 months of 1976.

relied on Section 204 of the Act to support the refund order.

The Solicitor General acknowledges that the FCC "did not expressly rest its [refund] order on Section 204" (Opp. 25), that the FCC's brief in the court of appeals "mistaken[ly]" argued that if the FCC "had no refund power except under Section 204 . . . carriers would be free to ignore . . . this rate of return prescription" (Opp. 27 n.23), and that the court of appeals stated "that Section 204 did not apply in this case" (Opp. 25).[4] However, noting that several groups petitioning for refunds had pointed out that Bell's rates had been the subject of an accounting order (Opp. 26), the Solicitor General now asserts that Section 204 provides an independent statutory predicate for the refund order.

The FCC was right to disavow reliance on Section 204 below. As the Solicitor General concedes (Opp. 24), the FCC had decided the rate of return issue prior to its issuance of the accounting order. Accordingly, the ensuing investigation and related Section 204 accounting did not focus on whether Bell's rates were designed to yield the prescribed rate of return, but instead on other issues, such as whether Bell's costs were allowable and properly calculated. *See In the Matter of AT&T*, 58 F.C.C.2d 1 (1976).[5] Thus, the investigation and accounting order did not pertain to the rate of return issue. *See* Pet. pp. 13-14 n.19.

In any event, Section 204 could not have been employed to order refunds in the manner now proposed by the Solicitor General. The focus of any investigation and

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[4] *See also*, Judge Buckley's statement, in his dissenting opinion in the *Refund Case*, that "the agency did not see fit to pursue the Section 204 remedy in this case." Pet. App. 29a.

[5] For example, if during the investigation the FCC had determined that Bell erred in the calculation of its costs, the FCC could have ordered refunds to correct that error irrespective of its impact upon Bell's return.

accounting under Section 204 and comparable provisions of other regulatory statutes is whether the rates were lawful when filed. Thus, an agency is authorized under Section 204 to investigate and order refunds where a carrier has " 'file[d] . . . a tariff *designed* to produce a rate of return in excess' " of the prescribed rate of return. *Nader v. FCC*, 520 F.2d 182, 205 n.25 (D.C. Cir. 1975), *quoting In the Matter of AT&T*, 51 F.C.C. 2d 619, 626 (1975) (emphasis added). But an agency cannot order refunds because years later the carrier's initially correct estimates of its costs, revenues, rate base, and other factors governing its rates no longer produce the return that they were designed to yield. *See, e.g., Delmarva Power & Light Co.* v. *FERC*, 770 F.2d 1131, 1138-39 (D.C. Cir. 1985) (Natural Gas Act); *Indiana & Michigan Municipal Distributors Ass'n* v. *FERC*, 659 F.2d 1193, 1197-98 (D.C. Cir. 1981) (Federal Power Act).

Here, Bell's rates were lawful when filed; for the first two years in which these rates were in effect they yielded earnings well within the range permitted by the FCC's prescription order. In these circumstances, an agency cannot use an accounting to conduct an open-ended inquiry and order refunds based on actual results reported three years after the rates were filed.[6]

3. Although respondents seek to minimize the impact of the decision below based upon pending or future proceedings at the FCC,[7] they do not deny that the principle

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[6] If the FCC's investigation determines that subsequent events have rendered existing rates unjust and unreasonable, Section 204 authorizes it to declare existing rates unlawful and to prescribe new rates for the future.

[7] Respondents contend (Opp. 28) that the FCC's recent adoption of "price cap" regulation for AT&T "would effectively moot the refund issue." We disagree. To begin with, the Commission has not adopted price cap regulation for any of the carriers that have petitioned this Court for certiorari and it does not even contemplate using such regulation for all carriers. At all events,

adopted by the D.C. Circuit in this case has broad applicability to all agencies that operate under regulatory regimes similar to that set forth in the Communications Act.[8]

Similarly, respondents seek to dismiss out of hand the numerous decisions that have applied the rule against retroactive ratemaking in a manner that would prohibit the type of action taken by the Commission here. In respondents' view (Opp. 19), those cases are inapposite because none involved agency enforcement of a rate-of-return prescription through a refund order. But that is precisely the point: Because the FCC's action is so clearly unauthorized, no other agency with comparable statutory authority has ever attempted to do what the FCC has done here.

Finally, there is no merit to respondents' assertion (Opp. 29) that the Court should await the outcome of the remand in the *Rulemaking Case* before resolving the statutory authority issue. As noted in the petition (p. 9), the *Rulemaking Case* endorsed the *Refund Case*, insofar as it upheld the FCC's authority to order refunds to enforce rate-of-return prescriptions, and that issue is not being revisited by the Commission on remand. In the meantime, the FCC has continued to order refunds for asserted violations of rate-of-return prescriptions in a

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the FCC still proposes to prescribe rates of return and it has not ruled out the imposition of retroactive refunds under a price cap regulatory regime.

[8] Respondents unsuccessfully attempt to limit the meaning of Judge Starr's statement, in his opinion dissenting from the denial of rehearing *en banc*, that the law in the D.C. Circuit is "distressingly unsettled" (Opp. 14 n.10). As Judge Starr's separate opinion in the *Rulemaking Case* makes clear (Pet. App. 154a-156a), the decision below upholding the FCC's refund order is contrary to other cases in this Court and in the D.C. Circuit applying the rule against retroactive ratemaking in a variety of regulatory contexts.

variety of contexts. *See* Brief of Amicus Curiae Communications Satellite Corp. at p. 4 and n.5. Thus, the question presented here is a pressing one that has great importance not only for the telecommunications industry, but also for the many other industries regulated by the federal government.

CONCLUSION

For the foregoing reasons and those set forth in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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